DEPARTMENT OF STATE REVENUE

02-20181344.LOF

Letter of Findings: 02-20181344
Corporate Income Tax
For the Years Ending 2011-2015

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 requires the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Letter of Findings.

HOLDING

Indiana Company provided sufficient documentation that its activity exceeded more than mere solicitation in the protested jurisdictions. Thus, Company's sales for those protested jurisdictions should not have been thrown back to Indiana.

ISSUE

I. Adjusted Gross Income Tax - Throwback Sales.

Authority: 15 U.S.C. § 381; IC § 6-3-2-1; IC § 6-3-2-2 (2013); IC § 6-8.1-5-1; *Indiana Dep't. of State Revenue v. Rent-A-Center East, Inc*., 963 N.E.2d 463 (Ind. 2012); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue,* 867 N.E.2d 289 (Ind. Tax Ct. 2007); *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480 (Ind. Tax Ct. 2012); *Sherwin-Williams Co. v. Indiana Dep't. of State Revenue*, 673 N.E.2d 849 (Ind. Tax Ct. 1996); *Wisconsin Dep't. of Revenue v. William Wrigley, Jr., Co.*, 505 U.S. 214 (1992); *Indiana Dep't of State Revenue v. Kimberly-Clark Corp.*, 416 N.E.2d 1264 (Ind. 1981); 45 IAC 3.1-1-38; 45 IAC 3.1-1-53; 45 IAC 3.1-1-64.

Taxpayer protests the imposition of additional adjusted gross income.

STATEMENT OF FACTS

Taxpayer is an Indiana company doing business in Indiana and outside of Indiana. Taxpayer, based on its nexus with Indiana, elected to file its Indiana corporate income tax returns and did not file with its affiliates, reporting its Indiana income tax for the years ending September 30, 2010, September 30, 2011, and September 30, 2012. The Indiana Department of Revenue ("Department") audited Taxpayer's business records for those tax years. Pursuant to the audit, the Department found that Taxpayer did not correctly report its income. The Department's audit thus made adjustments to the sales factor in Taxpayer's returns. The audit adjustments resulted in additional Indiana income for the tax years ending September 30, 2011, and September 30, 2012. The Department thus assessed additional income tax for the tax years ending September 30, 2011, and September 30, 2012 ("Tax Years at Issue").

Taxpayer protested the Department's proposed assessments of additional income tax. Specifically, Taxpayer protests the Department's assessments pertaining to its sales to Canadian sales and several U.S. jurisdiction sales for the Tax Years at Issue. A hearing was held. This Letter of Findings ensues. Additional facts will be provided as necessary.

I. Adjusted Gross Income Tax - Throwback Sales.

DISCUSSION

The Department's audit found that Taxpayer was not subject to income tax in various states, but it failed to include its sales to those states in computing the sales numerator of its Indiana returns for the Tax Years at Issue. Specifically, the Department's audit determined that Taxpayer did not have nexus with various states and its income derived from sales to those states were not subject to tax in those states under P.L.86-272. The audit thus applied the Indiana throwback rule, adjusting the sales factor, which resulted in additional Indiana income for the Tax Years at Issue. As a result, the audit imposed additional income tax for the Tax Years at Issue. Taxpayer disagrees with the Department's adjustments. Taxpayer protests the inclusion of throwback sales made to

customers in Alabama, Georgia, Illinois, Kentucky, Michigan, South Carolina, Tennessee, and Canada to the Indiana sales factor numerator. The Department notes that the throwback rule is only effect until December 31, 2015, any year after that the rule is not applicable.

As a threshold issue, all tax assessments are *prima facie* evidence that the Department's claim for the unpaid tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue,* 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007); *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc*., 963 N.E.2d 463, 466 (Ind. 2012). Thus, the taxpayer is required to provide documentation explaining and supporting its challenge that the Department's assessment is wrong. Poorly developed and non-cogent arguments are subject to waiver. *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480, 486 n.9 (Ind. Tax Ct. 2012).

"Indiana imposes a tax on every corporation's adjusted gross income derived from sources within Indiana. [IC § 6-3-2-1(b).] In cases where a corporation derives business income from sources both within and without Indiana, the 'adjusted gross income derived from sources within the state of Indiana' is determined by an apportionment formula." *Sherwin-Williams Co. v. Indiana Dep't. of State Revenue*, 673 N.E.2d 849, 851 (Ind. Tax Ct. 1996). That formula operates by multiplying taxpayer's total business income by a fraction composed of a property factor, a payroll factor, and a sales factor. IC § 6-3-2-2(b). The "sales factor" consists of a fraction, "the numerator of which is the total sales of the taxpayer in [Indiana] during the taxable year, and the denominator of which is the total sales of the taxpayer everywhere during the taxable year." IC § 6-3-2-2(e).

The basic rule for calculating the sales factor is found at IC § 6-3-2-2. IC § 6-3-2-2(e)(2013) provides that "sales of tangible personal property are in this state if . . . (2) the property is shipped from an office, a store, a warehouse, a factory, or other place of storage in this state and . . . (B) the taxpayer is not taxable in the state of the purchaser." IC § 6-3-2-2(n)(2013) provides that "[f]or purposes of allocation and apportionment of income under this article, a taxpayer is taxable in another state if: (1) in that state the taxpayer is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax; or (2) that state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not." Therefore, in order to properly attribute income to a foreign state, a taxpayer must show that one of the taxes listed in IC § 6-3-2-2(n)(1) has been levied against him or that the state has the jurisdiction to impose a net income tax regardless of "whether, in fact, the state does or does not." *Id*.

45 IAC 3.1-1-53 explains:

> Gross receipts from the sales of tangible personal property (except sales to the United States Government-See Regulation 6-3-2-2(e)(050) [45 IAC 3.1-1-54] are in this state: (a) if the property is delivered or shipped to a purchaser within this state regardless of the F.O.B. point or other conditions of sales; or (b) if the property is shipped from an office, store, factory, or other place of storage in this state, and the taxpayer is not taxable in the state of the purchaser. See Regulation 6-3-2-2(n)(010) [45 IAC 3.1-1-64].
>
> Examples:
> . . .
> (5) **If the taxpayer is not taxable in the state of the purchaser, the sale is attributed to this state if the property is shipped from an office, store, warehouse, factory, or other place of storage in this state. Such sale is termed a "Throwback" sale**. Example: The taxpayer has its head office and factory in State A. It maintains a branch office and inventory in Indiana. Taxpayer's only activity in State B is the solicitation of orders by a resident salesman. All orders by the State B salesman are sent to the branch office in Indiana for approval and are filled by shipment from the inventory in Indiana. Since the taxpayer is immune under P.L.86-272 from tax in State B, all sales of merchandise to purchasers in State B are attributed to Indiana, the state from which the merchandise was shipped.
> . . .
> (**Emphasis added**).

45 IAC 3.1-1-38 provides:

> For apportionment purposes, a taxpayer is "doing business" in a state if it operates a business enterprise or activity in such state including, but not limited to:
>
> (1) Maintenance of an office or other place of business in the state.
> (2) Maintenance of an inventory of merchandise or material for sale distribution, or manufacture, or

consigned goods.
(3) Sale or distribution of merchandise to customers in the state directly from company-owned or operated vehicles where title to the goods passes at the time of sale or distribution.
(4) Rendering services to customers in the state.
(5) Ownership, rental or operation of a business or of property (real or personal) in the state.
(6) Acceptance of orders in the state.
(7) **Any other act in such state which exceeds the mere solicitation of orders so as to give the state nexus under P.L.86-272 to tax its net income**.

As stated in Regulation 6-3-2-2(b)(010) [45 IAC 3.1-1-37], corporations doing business in Indiana as well as other states are subject to the allocation and apportionment provisions of IC 6-3-2-2(b)-(n). (**Emphasis added**).

45 IAC 3.1-1-64 further illustrates:

A corporation is "taxable in another state" under the Act when such state has jurisdiction to subject it to a net income tax. This test applies if the taxpayer's business activities are sufficient to give the state jurisdiction to impose a net income tax under the Constitution and statutes of the United States. **Jurisdiction to tax is not present where the state is prohibited from imposing the tax by reason of the provision of Public Law 86-272, 15 U.S.C.A. §381-385**. In the case of any "State," as defined in IC 6-3-1-25, other than a state of the United States or political subdivision of such state, the determination of whether such "state" has jurisdiction to subject the taxpayer to a net income tax shall be made by application of the jurisdictional standards applicable to that state of the United States. If jurisdiction to tax is otherwise present, such "state" is not considered as being without jurisdiction to tax by reason of the provisions of a treaty between that state and the United States.

Example:

Corporation X is actively engaged in manufacturing farm equipment in State A and foreign country B. Both State A and foreign country B impose a net income tax but foreign country B exempts corporations engaged in manufacturing farm equipment. Corporation X is subject to the jurisdiction of State A and foreign country B.

Taxpayers are not subject to throwback on sales into states in which they are taxable under this regulation [45 IAC 3.1-1-64]. See Regulation 6-3-2-2(e)(040) [45 IAC 3.1-1-53].

(**Emphasis added**).

15 U.S.C. § 381(a), which establishes minimum standards for a state to impose tax, provides:

No State, or political subdivision thereof, shall have power to impose, for any taxable year ending after September 14, 1959, a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:

(1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and

(2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1).

15 U.S.C. § 381(c) further states:

For purposes of subsection (a) of this section, a person shall not be considered to have engaged in business activities within a State during any taxable year merely by reason of sales in such State, or the solicitation of orders for sales in such State, of tangible personal property on behalf of such person by one or more independent contractors, or by reason of the maintenance, of an office in such State by one or more independent contractors whose activities on behalf of such person in such State consist solely of making sales, or soliciting orders for sales, of tangible personal property.

Accordingly, in every transaction, at least one state has the authority to impose tax on income derived from the sale of tangible personal property. A state could impose tax on a taxpayer if its activity within the state exceeds "solicitation of orders."

The court in *Indiana Dep't of State Revenue v. Kimberly-Clark Corp.*, 416 N.E.2d 1264 (Ind. 1981), found that the nonresident taxpayer did not exceed solicitation of orders for sales in Indiana because it only employed several salesmen who lived in Indiana to perform activities such as, checking inventories, checking shelf facings, and explaining products. *Id.* at 1266. The Kimberly-Clark court stated that "each case must be judged upon its own merits, with particular emphasis placed upon the totality of a corporation's activities within a state." *Id*. at 1268. The Kimberly-Clark court held that solicitation of orders for sales includes "sundry activities so long as those activities (are) closely related to the eventual sale of a product." *Id*. (Internal citation omitted). The Kimberly-Clark court concluded that the taxpayer's activities in Indiana were "inextricably related to solicitation" or as "acts of courtesy," and, therefore, the taxpayer was not taxable in Indiana. *Id*.

The U.S. Supreme Court refined the "mere solicitation" standard in *Wisconsin Dep't. of Revenue v. William Wrigley, Jr., Co.*, 505 U.S. 214 (1992). In *Wrigley*, the taxpayer, a manufacturer of chewing gum, claimed that P.L.86-272 prohibits Wisconsin from taxing its income because (1) it did not have any office (or real estate) in Wisconsin and (2) its business activities in Wisconsin were within the scope of solicitation of orders and were *de minimis*. *Id*. at 235. The Court disagreed and, in relevant part, stated:

> We proceed, therefore, to describe what we think the proper standard to be. Once it is acknowledged, as we have concluded it must be, that "solicitation of orders" covers more than what is strictly *essential* to making requests for purchases, the next (and perhaps the only other) clear line is the one between those activities that are *entirely ancillary* to requests for purchases–those that serve no independent business function apart from their connection to the soliciting of orders–and those activities that the company would have reason to engage in anyway but chooses to allocate to its in-state sales force. Providing a car and a stock of free samples to salesmen is part of the "solicitation of orders," because the only reason to do it is to facilitate requests for purchases. Contrariwise, employing salesmen to repair or service the company's products is not part of the "solicitation of orders," since there is good reason to get that done whether or not the company has a sales force. Repair and servicing may help to *increase* purchases; but it is not ancillary to *requesting purchases*, and cannot be converted into "solicitation" by merely being assigned to salesmen.
>
> *Id*. at 228-29. (*Emphasis in original*) (Internal citation omitted).

The Court further explained:

> By contrast, Wrigley's in-state recruitment, training, and evaluation of sales representatives and its use of hotels and homes for sales-related meetings served no purpose apart from their role in facilitating solicitation. The same must be said of the instances in which Wrigley's regional sales manager contacted the Chicago office about "rather nasty" credit disputes involving important accounts in order to "get the account and [Wrigley's] credit department communicating." It hardly appears likely that this mediating function between the customer and the central office would have been performed by some other employee – some company ombudsman, so to speak – if the on-location sales staff did not exist. The purpose of the activity, in other words, was to ingratiate the salesman with the customer, thereby facilitating requests for purchases.
>
> Finally, Wrigley argues that the various nonimmune activities, considered singly or together, are *de minimis*. In particular, Wrigley emphasizes that the gum sales through "agency stock checks" accounted for only 0.00007 [percent] of Wrigley's annual Wisconsin sales, and in absolute terms amounted to only several hundred dollars a year. We need not decide whether any of the nonimmune activities was *de minimis* in isolation; taken together, they clearly are not. Wrigley's sales representatives exchanged stale gum, as a matter of regular company policy, on a continuing basis, and Wrigley maintained a stock of gum worth several thousand dollars in the State for this purpose, as well as for the less frequently pursued (but equally unprotected) purpose of selling gum through "agency stock checks." Although the relative magnitude of these activities was not large compared to Wrigley's other operations in Wisconsin, we have little difficulty concluding that they constituted a nontrivial additional connection with the State. Because Wrigley's business activities within Wisconsin were not limited to those specified in § 381, the prohibition on net-income taxation contained in that provision was inapplicable.

Id. at 234-5.

Ruling in favor of Wisconsin, the Court thus held that the taxpayer in *Wrigley* was subject to Wisconsin's net

income tax because its business activities in Wisconsin exceeded P.L.86-272's protection. *Id.* at 235.

Thus, following the *Wrigley* decision, an Indiana company's income derived from its sales to other states is thrown back to Indiana for income tax purposes when the Indiana company's business activities in those states are protected and are not taxable pursuant to P.L.86-272.

As stated above the Department threw back sales from Canada, Alabama, Georgia, Illinois, Kentucky, Michigan, South Carolina, and Tennessee to Indiana. Taxpayer agreed during the audit and in the hearing that sales from the United Kingdom should be included in Taxpayer's numerator of the sales factor therefore no discussion regarding the United Kingdom sales will occur in this decision. This decision will however discuss the foreign jurisdiction separate from the U.S. jurisdictions.

Canada

During the audit, Taxpayer was asked to establish that its activities within Canada exceeded mere solicitation. According to the auditor:

> [T]he taxpayer provided the auditors with a thirty-two (32) page document dated 8/28/2017. . . .
>
> According to the document emailed by [representative], employees of [Taxpayer] traveled to customer locations in Canada to provide customers with sales/services which exceeded mere solicitation. The document assumed that the taxpayer's employees traveled to [several places in Canada].
>
> The author of the above-referenced document stated that during the investigation period, quality issues arose with respect to the taxpayer's products that directly affected its Canadian customers. As a result, it was necessary for [Taxpayer's] employees to travel to Canada to address these quality issue concerns. The taxpayer performed quality control functions; conducted post-sales meetings; and discussed process improvements and technical issues regarding the [] products. As a result, the taxpayer contends that the above activities are "independent and ancillary of the solicitation of sales activities that occurred in Canada . . .". Therefore, the taxpayer asserts that it has established nexus in Canada, and it would be subject to an income tax in Canada (even though an income tax return has not been filed in Canada for CY 2012-2015).

Within the 32 page document received, Taxpayer provided expense reports and meal/hotel receipts for a trip taken by employees in 2015. Also provided to the auditor were plane tickets, receipts, and job descriptions of the traveling employees. Based on the documentation the Department determined that the employees only had one and a half hours to meet with customers. The audit report concluded that:

> No documentation has been provided to confirm that any technical presentations or quality assurance services were provided to those customers during this 1 to 1 1/2 hour visit. Furthermore, no documentation has been provided to confirm that the activities of the three [] employees that traveled to Canada on [2015 dates] exceeded mere solicitation. Consequently, the sales to customers within Canada should be included in the numerator of the sales factor.
>
> For calendar year 2012, the sales to Canadian customers were included in the numerator of the sales factor on the original income tax return. NOTE: This is the reason that the amended income tax returns were filed. Since the taxpayer has not established that the activities in Canada exceed mere solicitation, the sales to customers in that jurisdiction should be "thrown back" to Indiana and included in the numerator. No adjustment needs to be made for this year, and these sales have been included in the numerator. No adjustment needs to be made for this year, and these sales have been included in the throwback sales computation, per this investigation.
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> For calendar years 2013, 2014, and 2015, the sales to customers in Canada were not included in the sales factor numerator on the income tax returns. . . . Therefore, the sales to customers in Canada should be "thrown back" to Indiana.

During the protest, Taxpayer was able to provide additional information including emails between Taxpayer and Canadian customers. These emails include discussions regarding shipment of product, quality assurance issues, and planning a trip with a plant tour.

As stated in *Wrigley*, the action must be separate from what is essential to making requests to purchases; the action must serve as an "independent business function. . . . Repairing and servicing may help to increase

purchases; but it is not ancillary to requesting purchases, and cannot be converted into 'solicitation' by being assigned to salesmen." *Wrigley*, 505 U.S. 214 at 228-29. The emails provided by Taxpayer do discuss shipping and quality assurance. In addition, there were emails to discuss ways to improve the product and shipping. Based in the test laid out in *Wrigley*, the Department incorrectly threw back sales from Canada to Indiana. Taxpayer met its burden under IC § 6-8.1-5-1(c), and its protest is sustained regarding Canadian sales.

U.S. Jurisdictions

Next, Taxpayer protests the Department throwing back sales from Alabama, Georgia, Illinois, Kentucky, Michigan, South Carolina, and Tennessee. During the audit the Department requested "details to support that nexus has been established in each state that was not thrown back." Taxpayer provided each relevant state's income tax returns. In this instance, Taxpayer provided income tax returns for the U.S. jurisdiction states at issue. Some of the returns were combined returns with Taxpayer's parent. The Department's auditor report threw back sales from combined return states because filing alone is not conclusive of "doing business" in those states.

IC § 6-3-2-2(n)(2013) states that "For purposes of allocation and apportionment of income under this article, a taxpayer is taxable in another state if: (1) in that state the taxpayer is subject to a net income tax . . . or (2) that state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not." Indiana defines doing business in a state if a taxpayer operates business activity such as "(4) rendering services to customers in the state, (5) ownership, rental or operation of a business or of property (real or personal) in the state, (6) Acceptance of orders in the state, or (7) any other act in such state which exceeds the mere solicitation of orders so as to give the state nexus under P.L.86-272 to tax its net income." 45 IAC 3.1-1-38.

Taxpayer provided its returns for the protested U.S. jurisdictions to show that they were taxable in those jurisdictions. Upon review of these returns it is clear that Taxpayer was subject to income tax as required by IC § 6-3-2-2(2013). Thus, Taxpayer has met its burden under IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protest is sustained.

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An html version of this document.